

**REPORT OF EXAMINATION**  
**RED SHIELD INSURANCE COMPANY**

**Seattle, Washington**

**December 31, 1998**



States Participating

Washington

I hereby certify that the attached Report of Examination shows the financial condition and affairs of RED SHIELD INSURANCE COMPANY of Seattle, Washington as of December 31, 1998.

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PATRICK H. McNAUGHTON  
Chief Examiner

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Date

# RED SHIELD INSURANCE COMPANY

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**RED SHIELD INSURANCE COMPANY**

Seattle, Washington  
March 24, 2000

Hon. George Nichols, III  
Commissioner, Kentucky Insurance Dept.  
Chair, NAIC Financial Condition (EX4)  
215 West Main Street  
Frankfort, KY 40602-0517

Hon. Jose Montemayor  
Commissioner, Texas Department of Insurance  
NAIC Secretary, Western Zone  
PO Box 149104  
Austin, TX 78714-9104

Hon. Deborah Senn  
Commissioner, Washington Office of Insurance Commissioner  
PO Box 40255  
Olympia, WA 98504-0255

Dear Commissioners:

In accordance with your instructions and in compliance with the statutory requirements of Chapter 48.03 RCW, an examination was made of the corporate affairs and financial records of

**RED SHIELD INSURANCE COMPANY**

of

Seattle, Washington

hereinafter referred to as the "Company" or "RSC," at its home office located at 7245 West Marginal Way SW, Seattle, Washington 98106-3997.

The Report of Examination is respectfully submitted showing the condition of the Company as of December 31, 1998.

**SCOPE OF EXAMINATION**

Per RCW 48.03.010, the examination covered the five-year period from January 1, 1994 through December 31, 1998. On May 4, 1999, an Association Examination was called and addressed to all zone secretaries. No NAIC Zone examiners participated in the current examination.

The examination followed the statutory requirements contained in the Washington Insurance Code and the guidelines prescribed in the NAIC Financial Condition Examiner's Handbook. RSC's operating procedures and financial records were reviewed as considered necessary to ascertain the financial condition of the Company and conformity with related laws. These matters are discussed in various sections of the report. The examination included identification and disposition of material transactions and events occurring subsequent to December 31, 1998.

## **RED SHIELD INSURANCE COMPANY**

### **\*\*\*\*\*INSTRUCTIONS**

The Company is instructed to comply with the following:

1. Amend the Bylaws to reflect the change to the current principal place of business in accordance with RCW 48.07.020. See page 9.
2. Obtain an appraisal of the real property securing a mortgage loan at the time of the acquisition of the mortgage in compliance with RCW 48.13.140. See page 20.
3. Comply with the 4% limitation in investments found in RCW 48.13.030. The amount of \$335,557, which is in excess of the 4% limitation, will be non-admitted in the financial statement. See page 19.
4. Include salaries paid to the claims department employees located in Portland, Oregon in the loss adjustment expenses in compliance with RCW 48.12.140. See page 19.

## **RED SHIELD INSURANCE COMPANY**

### **COMMENTS AND RECOMMENDATIONS**

It is recommended that all officers and directors individually complete a separate and dated Conflict of Interest Statement rather than signing in an acknowledgement page. The currently signed Conflict of Interest Statement should also be updated to exclude officers that have terminated their employment with the Company. See page 6.

## **RED SHIELD INSURANCE COMPANY**

### **HISTORY**

The Company was incorporated on February 9, 1979, as a stock multiple line property and casualty insurer in the state of Washington. The Insurance Commissioner, on February 28, 1979, issued the original certificate of authority. Additionally, the Company holds a certificate of authority from the United States Department of Labor under the Longshore and Harbor Workers' Compensation Act. The Company specializes in underwriting general liability, residual dwelling, inland and ocean marine, as well as U.S. Longshore and Harbor (USL&H) Workers' Compensation and liability for stevedoring operations.

### **CAPITAL AND SURPLUS**

The original authorized capital of the Company was 10,000 shares of common capital stock with par value of \$100 per share. RSC issued one stock certificate for 6,500 shares of common capital stock to Maritime Service Company in consideration for \$1,300,000 which was obtained through a loan from Rothschild International Corporation. The consideration was split equally between paid-in capital stock and paid-in surplus.

A "written consent" resolution of the Board of Directors on December 19, 1983, amended the Articles of Incorporation which increased the authorized capital stock to 25,000 common shares at \$100 par value per share. The Company then issued a second stock certificate for 6,500 additional shares of common capital stock to Maritime Service Company and through the same "written consent" resolution of the Board of Directors transferred \$650,000 of contributed surplus to paid-in capital which increased the overall paid-in capital to \$1,300,000 and reduced the contributed surplus to zero. All of the issued and outstanding shares of stock of the Company are wholly owned by Maritime Service Company, a managing service company, which in turn, is wholly owned by Rothschild International Corporation, a corporation in which Mr. Clayton R. Jones has a majority ownership.

### **DIVIDENDS**

The Board of Directors passed a "written consent" resolution approving the payment of stockholder dividends to the shareholder of record as follows:

December 21, 1995	\$ 250,000
December 18, 1996	250,000
December 29, 1997	6,000,000



## RED SHIELD INSURANCE COMPANY

### MANAGEMENT

#### Board of Directors

Article IV, Section 1 of the Bylaws state that a Board of Directors shall manage the business affairs of the Corporation. The Board is comprised of five (5) members. Election to fill vacancies existing or occurring in the Board shall be held at the annual meeting of the stockholders, and directors so elected shall hold office until their respective successors shall have been elected and qualified.

The following directors, officers and committee members are serving the Company as of December 31, 1998:

<u>Directors</u>	<u>Principal Business Affiliation</u>	<u>Residence</u>
Clayton R. Jones	President and Director: Rothschild International Corporation Maritime Service Company Red Shield Insurance Company Red Shield Service Company Red Shield Financing Company	Seattle, WA
Genevieve S. Jones	Vice President, Asst. Secretary and Director: Rothschild International Corporation Maritime Service Company	Seattle, WA
Frank J. Amato	Secretary and Director: Red Shield Insurance Company Treasurer, Assistant Secretary and Director: Rothschild International Corporation Assistant Secretary and Director: Maritime Service Company Vice President and Director: Red Shield Service Company Red Shield Financing Company	Bellevue, WA
Edward D. Fournier	Vice President and Director: Red Shield Service Company Red Shield Insurance Company	Bellevue, WA
John P. Visich	Treasurer and Director: Red Shield Insurance Company Assistant Treasurer: Red Shield Service Company Red Shield Financing Company	Bellevue, WA

#### Officers

Article VI, Section 1 of the Bylaws provides that the Board of Directors shall choose the following officers of the Company: President, one or more Vice Presidents, a Secretary and a Treasurer. The Board of Directors may also elect a Chairman of the Board from among its members.

## **RED SHIELD INSURANCE COMPANY**

### **Name**

### **Title**

Clayton R. Jones	President
Edward D. Fournier	Vice President
Frank J. Amato	Secretary and Assistant Treasurer
John P. Visich	Treasurer and Assistant Secretary
James A. Wenger	Assistant Secretary

### **Executive Committee**

Article IV, Section 3 of the Bylaws provides that the Board of Directors may establish an Executive Committee and other permanent or temporary committees. An investment committee has been established since inception of the Company.

### **Investment Committee**

Although not provided for in the Bylaws, an Investment Committee has been established and active since inception of the Company.

### **Conflict of Interest**

It has been and is the opinion of the President that this Company has had, since its inception, an unwritten conflict of interest policy. The President believes that each of the directors, officers, and other persons of responsibility has known this and have conducted their actions accordingly.

The Company has a two page Conflict of Interest Statement that is in compliance with RCW 48.07.130. All the officers and directors sign the acknowledgement page. The Conflict of Interest Statement is updated regularly; however, the officers and directors who terminated their services were still included in the master copy.

It is recommended that all officers and directors individually complete a separate and dated Conflict of Interest Statement rather than signing the acknowledgement page. The currently signed Conflict of Interest Statement should be updated to exclude officers that have terminated their employment with the Company.

### **Minutes**

The examiners reviewed the minutes of the Shareholders, Board of Directors, and committee of the Board for the period covered under examination.

## RED SHIELD INSURANCE COMPANY

### AFFILIATED COMPANIES

Chapter 48.31B RCW requires the Company file an Insurance Holding Company System Registration Statement. The examination disclosed that filings were made through March 30, 1999 as noted in the revised Form B Registration statement.

**Rothschild International Corporation** is the upstream holding company which owns 100% of the stock of the Maritime Service Company. The ultimate controlling person, by virtue of majority ownership of the common stock, is Mr. Clayton R. Jones. Mr. Jones is an Executive/Investor, and holds the office of President in all of the subsidiary companies.

**Maritime Service Company (MSC)** owns 100% of the stock of Red Shield Insurance Company, Red Shield Financing Company, and Red Shield Service Company. MSC has and may loan unsecured amounts to its subsidiaries for short periods. No secured loans or exchanges of securities between subsidiaries exist.

Any compensation exchanged between MSC's subsidiaries is based on cost allocations using accepted accounting principles, which include provision for reasonable profit. This does not appear to be in accordance with statutory accounting requirements or current regulatory requirements, and will be evaluated during the review of the 1999 Annual Statement filing.

**Red Shield Financing Company** has contracted with Red Shield Insurance Company (RSC) to provide an accounts receivable service to collect premiums on behalf of the Company.

**Red Shield Service Company** contracts with RSC for some management services; primarily, claims management and safety engineering.

Related party transactions were identified which included service fees paid, premiums earned, and loss payments. All appear to contain proper accounting and disclosure.

The following organizational chart is taken in part from the filed 1998 annual statement:

**RED SHIELD INSURANCE COMPANY**

## **RED SHIELD INSURANCE COMPANY**

### **CORPORATE RECORDS**

A Board of Directors manages the property and business of the Company. A review of the minutes of the Board of Directors showed that the Board through a "Written Consents in Lieu of a Meeting" authorizes the business meetings. The execution of the consent was included in the minutes for each item of business and as such, appears to constitute a written waiver of any notice required by the Washington Business Corporation Act and the Company's Articles of Incorporation and Bylaws. It was noted that the Bylaws do not reflect the current principal place of business in accordance with RCW 48.07.020. The Company is instructed to amend the Bylaws to reflect the change to the current principal place of business in accordance with RCW 48.07.020.

Investment purchases, transfers, and disposals were ratified by the Board and noted in the minutes. Appointments and elections of officers, reinsurance contracts, bank agreements, and other contracts were also noted in the Board minutes.

### **Contracts/Service Agreements**

The Company's federal income tax returns are consolidated with Rothschild International Corporation and its subsidiaries and affiliated companies as shown in Schedule Y of the annual statement. The method of allocation between the companies is subject to a written agreement approved by the Board of Directors. The terms and conditions of this agreement require an allocation of taxes based upon separate return calculations resulting in a tax charge or refund of not more than the amount each company would have paid or received if it had filed on a separate return basis.

### **INTERNAL SECURITY**

#### **Fidelity Bonds**

The Company is a named insured under a Financial Institution Bond written in the name of Rothschild International Corporation, which provides the following coverages:

Employee Dishonesty	\$1,000,000 (\$25,000 deductible)
Forgery or Alteration	\$1,000,000 (\$25,000 deductible)
Securities	\$1,000,000 (\$25,000 deductible)
Loss on the Premises	\$ 100,000 (\$ 1,000 deductible)
Loss in Transit	\$ 100,000 (\$ 1,000 deductible)
Depositors' Forgery	\$1,000,000 (\$25,000 deductible)

The fidelity coverage carried by the Company exceeds the minimum requirements by the National Association of Insurance Commissioners.

#### **Other Insurance**

The Company is also a named insured under a Property and Equipment policy written in the name of Maritime Service Company. The policy covers a wide range of exposures, which includes thirty locations, valuable paper loss to \$50,000, and replacement cost on scheduled EDP equipment.

#### **Internal Controls**

The Company retained the firm of Ernst & Young, Certified Public Accountants, to audit its statutory financial statements for the year ended December 31, 1998. The firm issued a report on internal controls as part of the audits with no material weaknesses noted. The examiners also independently tested internal controls and found no material weaknesses.

#### **Internal Audit Function**

RSC has no internal audit department.

## **RED SHIELD INSURANCE COMPANY**

### **OFFICERS AND EMPLOYEES WELFARE AND PENSION PLANS**

The Company has no pension plan for employees. However, a check is given in conjunction with year-end bonus as determined by the President for each employee to buy individual retirement account.

The Company obtains health coverage through Regence Blue Shield and pays for the employee premiums and partly subsidizes dependent premiums. Employees pay the majority of the premiums on dependents.

The Company also sponsors a dental plan by paying a small portion of employee premium. The employee pays all dental premium for dependents.

There is a vision plan for employees only that started in 1999. There are no other plans.

### **TERRITORY AND PLAN OF OPERATION**

The original Certificate of Authority was issued by the Washington Insurance Commissioner (OIC) on February 28, 1979, to transact the business of: Disability, Property, Marine and Transportation, Vehicle, General Casualty and Surety as defined in RCW 48.11.030 through RCW 48.11.080. The Company was licensed to operate in the following states as of December 31, 1998:

Arizona	California	Colorado
Idaho	Montana	Oregon
Utah	Washington	

Additionally, the Company holds a Certificate of Authority from the U. S. Department of Labor under the Longshore and Harbor (USL&H) Workers' Compensation Act. The Company specializes in underwriting general liability, residual dwelling, inland and ocean marine, as well as U.S. Longshore & Harbor (USL&H) Workers' Compensation, and liability for stevedoring operations. Policies are written on a non-assessable basis using ISO forms. Workers compensation is generally written with high deductibles. The USL&H and related liability business is produced on a direct basis and the remaining lines of business are produced by 354 independent agents. Currently 83% of its total premium volume is derived through its independent agency network. The Company writes most of its business in the states of Washington and Oregon.

USL&H is underwritten in the Seattle office and written only on the Jones' Stevedoring group of companies' employees. Liability coverage is also offered to these companies. The Portland office underwrites policies other than USL&H and is the marketing office for the business other than the stevedoring companies.

One new policy line has been added during the last five years. The Company has recently hired a marketing person to visit agents. Because of the change in demand for stevedoring services and an increased emphasis on the other lines of business, there has been a slight shift in business from the workers' compensation and stevedoring liability lines to other lines of business.

The Company appoints agents and brokers directly for the sale of its products. Commissions are paid directly to agents and brokers.

## RED SHIELD INSURANCE COMPANY

### GROWTH OF COMPANY

The following schedule shows the growth of the Company taken from the filed annual statements and from OIC reports of examination:

<u>Year</u>	<u>Net Premiums Written</u>	<u>Net Losses Paid</u>	<u>Admitted Assets</u>	<u>Surplus as Regards Policyholders</u>
1993*	\$ 4,098,398	\$ 970,475	\$ 28,303,807	\$ 17,987,838
1994	3,801,749	810,429	29,744,025	19,119,058
1995	3,939,539	1,315,001	31,000,369	20,084,050
1996	5,599,448	2,028,523	33,200,260	21,238,105
1997	5,875,202	1,660,501	30,685,502	16,997,824
1998*	5,051,501	1,859,448	30,838,621	18,090,054

#### **\*Per OIC Examination**

### REINSURANCE

The Company cedes and assumes reinsurance. All reinsurance agreements in effect as of December 31, 1998 were reviewed. The Company has Quota Share Agreements with two reinsurance companies. The primary cessions for all lines of business are made to a company that is unauthorized in the state of Washington. The Company has withheld funds from the unauthorized reinsurer sufficient to pay for potential losses in compliance with RCW 48.12.160(1)(c)(i).

Multiline insurance coverages other than the U.S. Longshore & Harborworkers' Compensation coverage and Stevedores Comprehensive General Liability coverage are ceded to an authorized reinsurer.

The Company appears to be in compliance with the Washington Insurance Code and NAIC guidelines regarding authorized and unauthorized reinsurers. The review of the contracts disclosed that the contracts appear to have a transfer of risk. The treaties include the insolvency clause in compliance with RCW 48.12.160(3).

### ACCOUNTING RECORDS AND PROCEDURES

#### Accounting Records

The Company's accounts and records are kept mostly manually. The Company's treasurer performs the accounting and preparation of its annual statement. A personal computer is used by the treasurer to prepare certain aspects of the Company's accounts and records.

The Oregon Office operations uses a computer for its underwriting and claims servicing process but gives the Seattle Office totals for manual input to the general ledger.

The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the planning phase of the examination and a trial balance prepared for the year ended December 31, 1998. The Company's independent auditors and actuarial consultant work papers were used whenever feasible to eliminate duplication of work.

#### Actuarial Opinion

The actuarial staff of the Insurance Commissioner's Office reviewed the reserves for the Company's unpaid loss and loss adjustment expenses. The OIC's actuarial staff's estimates of these liabilities are higher than the reserves carried by the Company. The Company staff proficiently executes its case-based reserving program and determines appropriate IBNR amounts. The amount of differences was immaterial; therefore, no examination adjustments are made in the examination report.

## **RED SHIELD INSURANCE COMPANY**

### **SUBSEQUENT EVENTS**

There are no events or pending transactions that occurred after December 31, 1998 that would have a material effect on the financial statements.

### **COMMENTS ON RECOMMENDATIONS FROM PREVIOUS EXAMINATION**

The comments and recommendations made in the last examination have been addressed.



## **RED SHIELD INSURANCE COMPANY**

### **FINANCIAL STATEMENTS**

The following statements present the financial condition of the Company as of December 31, 1998 as determined by this examination:

Balance Sheet  
As of December 31, 1998

Statement of Income  
Year Ended December 31, 1998

Capital and Surplus Account  
As of December 31, 1998

Comparative Balance Sheet  
As of December 31, 1998 and 1997

Comparative Statement of Income  
Years Ended December 31, 1998 and 1997

Comparative Capital and Surplus Account  
As of December 31, 1994 through 1998

Analysis of Examination Changes in Financial Statements  
As of December 31, 1998

# RED SHIELD INSURANCE COMPANY

## BALANCE SHEET AS OF DECEMBER 31, 1998

	BALANCE PER COMPANY	EXAMINATION ADJUSTMENT S	BALANCE PER EXAMINATION	Notes
<u>ASSETS</u>				
Bonds	\$21,281,832		\$21,281,832	
Preferred stocks	917,778		917,778	
Common stocks	1,393,425		1,393,425	
Mortgage loans on real estate	426,349		426,349	
Cash on hand and on deposit	230,315		230,315	
Short-term investments	5,635,151	(335,557)	5,299,594	1
Other invested assets	137,000		137,000	
Premiums in course of collections less ceded reins.	620,247		620,247	
Federal income tax recoverable	282,111		282,111	
Interest, dividends and real estate income due and accrued	249,970		249,970	
Total Assets	<u>\$31,174,178</u>	<u>(\$335,557)</u>	<u>\$30,838,621</u>	

	BALANCE PER COMPANY	EXAMINATION ADJUSTMENT S	BALANCE PER EXAMINATION	Notes
<u>LIABILITIES</u>				
Losses	\$4,392,738		\$4,392,738	2
Loss adjustment expenses	404,666		404,666	3
Other expenses (excluding taxes, licenses & fees)	150,371		150,371	
Taxes, licenses & fees (excl. fed. inc. tax)	36,774		36,774	
Borrowed money	0		0	
Unearned premiums	2,246,995		2,246,995	
Funds held by company under reinsurance treaties	3,883,815		3,883,815	
Excess of statutory reserves over statement reserves	1,616,000		1,616,000	
Payable to parent, subsidiaries and affiliates	17,208		17,208	
Total liabilities	<u>12,748,567</u>	<u>0</u>	<u>12,748,567</u>	
<u>SURPLUS AND OTHER FUNDS</u>				
Common capital stock	1,300,000		1,300,000	
Unassigned funds (surplus)	17,125,611	(335,557)	16,790,054	1
Surplus as regards policyholders	18,425,611	(335,557)	18,090,054	
Total liabilities, surplus and other funds	<u>\$31,174,178</u>	<u>(\$335,557)</u>	<u>\$30,838,621</u>	

**RED SHIELD INSURANCE COMPANY**  
**STATEMENT OF INCOME**  
**YEAR ENDED DECEMBER 31, 1998**

	BALANCE PER COMPANY	EXAMINATION ADJUSTMENTS	BALANCE PER EXAMINATION	Notes
<u>UNDERWRITING INCOME</u>				
Premiums earned	\$5,147,699		\$5,147,699	
DEDUCTIONS:				
Losses incurred	1,625,248		1,625,248	
Loss expenses incurred	741,794		741,794	
Other underwriting expenses incurred	2,450,809		2,450,809	
Total underwriting deductions	4,817,851	0	4,817,851	
Net underwriting gain or (loss)	329,848	0	329,848	
<u>INVESTMENT INCOME</u>				
Net Investment Income earned	1,408,917		1,408,917	
Net investment income gain or (loss)	1,408,917	0	1,408,917	
Net income before federal and foreign income taxes	1,738,765	0	1,738,765	
Federal and foreign income taxes incurred	467,887		467,887	
Net income	\$1,270,878	\$0	\$1,270,878	

**CAPITAL AND SURPLUS ACCOUNT**  
**AS OF DECEMBER 31, 1998**

Surplus as regards policyholders, December 31, previous year	\$16,997,824		\$16,997,824
<u>GAINS AND (LOSSES) IN SURPLUS</u>			
Net income	1,270,878	0	1,270,878
Net unrealized capital gains or (losses)	135,840		135,840
Change in non-admitted assets	(111,931)	(335,557)	(447,488)
Change in excess of statutory reserves over statement reserves	133,000		133,000
Changes in surplus	1,427,787	(335,557)	1,092,230
Surplus as regards policyholders, December 31, current year	\$18,425,611	(\$335,557)	\$18,090,054

**RED SHIELD INSURANCE COMPANY**  
**COMPARATIVE BALANCE SHEET**  
**AS OF DECEMBER 31,**

	<u>1998</u>	<u>1997</u>
<u>ASSETS</u>		
Bonds	\$21,281,832	\$26,395,699
Preferred stocks	917,778	847,314
Common stocks	1,393,425	1,203,187
Mortgage loans on real estate	426,349	528,035
Cash on hand and on deposit	230,315	185,667
Short-term investments	5,299,594	468,982
Other invested assets	137,000	168,930
Premiums in course of collections less ceded reins.	620,247	470,161
Federal income tax recoverable	282,111	44,994
Interest, dividends and real estate income due and accrued	249,970	372,533
Total Assets	<u>\$30,838,621</u>	<u>\$30,685,502</u>
* As adjusted by examination		
<u>LIABILITIES</u>		
Losses	\$4,392,738	\$4,626,938
Loss adjustment expenses	404,666	300,699
Other expenses (excluding taxes, licenses & fees)	150,371	104,676
Taxes, licenses & fees (excl. fed. inc. tax)	36,774	10,118
Borrowed money		1,300,000
Unearned premiums	2,246,995	2,343,193
Funds held by company under reinsurance treaties	3,883,815	3,222,860
Excess of statutory reserves over statement reserves	1,616,000	1,749,000
Payable to parent, subsidiaries and affiliates	17,208	30,194
Total liabilities	<u>12,748,567</u>	<u>13,687,678</u>
<u>SURPLUS AND OTHER FUNDS</u>		
Common capital stock	1,300,000	1,300,000
Unassigned funds (surplus)	16,790,054	15,697,824
Surplus as regards policyholders	18,090,054	16,997,824
Total liabilities, surplus and other funds	<u>\$30,838,621</u>	<u>\$30,685,502</u>

\* As adjusted by examination

**RED SHIELD INSURANCE COMPANY**  
**COMPARATIVE STATEMENT OF INCOME**  
**FOR THE YEARS ENDED DECEMBER 31,**

	<u>1998</u>	<u>1997</u>
<u>UNDERWRITING INCOME</u>		
Premiums earned	\$5,147,699	<u>\$5,606,741</u>
DEDUCTIONS:		
Losses incurred	1,625,248	1,942,122
Loss expenses incurred	741,794	702,080
Other underwriting expenses incurred	2,450,809	<u>2,407,659</u>
Total underwriting deductions	<u>4,817,851</u>	<u>5,051,861</u>
Net underwriting gain or (loss)	<u>329,848</u>	<u>554,880</u>
<u>INVESTMENT INCOME</u>		
Net Investment Income earned	1,408,917	<u>1,724,070</u>
Net investment income gain or (loss)	<u>1,408,917</u>	<u>1,724,070</u>
Net income before federal and foreign income taxes	1,738,765	2,278,950
Federal and foreign income taxes incurred	467,887	<u>710,006</u>
Net income	<u>\$1,270,878</u>	<u>\$1,568,944</u>

**COMPARATIVE CAPITAL AND SURPLUS ACCOUNT**  
**AS OF DECEMBER 31,**

	<u>1998</u>	<u>1997</u>	<u>1996</u>	<u>1995</u>	<u>1994</u>
Surplus as regards policyholders,					
December 31, previous year	\$16,997,824	\$21,238,105	\$20,084,050	\$19,119,058	<u>\$17,987,838</u>
<u>GAINS AND (LOSSES) IN SURPLUS</u>					
Net income	1,270,878	1,568,944	1,362,540	1,247,893	979,000
Net unrealized capital gains or (losses)	135,840	280,812	(111,866)	280,252	(263,218)
Change in non-admitted assets	(447,488)	(7,037)	24,381	(34,153)	5,438
Change in excess of statutory reserves					
over statement reserves	133,000	(83,000)	129,000	(279,000)	410,000
Surplus adjustments	0	(6,000,000)	(250,000)	(250,000)	
Changes in surplus	<u>1,092,230</u>	<u>(4,240,281)</u>	<u>1,154,055</u>	<u>964,992</u>	<u>1,131,220</u>
Surplus as regards policyholders,					
December 31, current year	<u>\$18,090,054</u>	<u>\$16,997,824</u>	<u>\$21,238,105</u>	<u>\$20,084,050</u>	<u>\$19,119,058</u>

**RED SHIELD INSURANCE COMPANY**  
*ANALYSIS OF EXAMINATION CHANGES IN FINANCIAL STATEMENTS*  
*AS OF DECEMBER 31, 1998*

	Increase (Decrease)	<u>Notes</u>
Surplus as regards policyholders, per company	\$18,425,611	
<u>ASSETS</u>		
Short-term investments	(335,557)	1
<u>LIABILITIES</u>		
Net Increase/(Decrease) to surplus	<u>(335,557)</u>	1
Surplus as regards policyholders, per examination	<u><u>\$18,090,054</u></u>	

## RED SHIELD INSURANCE COMPANY

### NOTES TO FINANCIAL STATEMENTS

#### **1. Short Term Investments**

The Company invested in the Ford Motor Credit Company in the aggregate amount of \$1,582,524 as of December 31, 1998. This amount exceeded the 4% investment limitation found in RCW 48.13.030 and the amount of \$335,557 will be non-admitted.

#### **2. & 3. Loss and Loss Adjustment Expense Reserves**

The reserves carried by the Company for these liabilities were \$4,392,738 and \$404,666, respectively, as of December 31, 1998.

The OIC actuarial staff's best estimates of these liabilities are higher than the reserves carried by the Company. The Company staff proficiently executes their case-based reserving program and determines appropriate IBNR amounts. No examination adjustments are made in the examination report.

#### **Instruction:**

The Company should record as unallocated loss adjustment expenses the salaries and expenses of three Portland employees who are involved primarily in the handling of claims in compliance with RCW 48.12.140. Per the OIC actuarial staff's loss reserves calculation, only the ULAE reserves are affected as a result of the inclusion of three Portland claims employees, as follows:

	With Oregon	Without Oregon	Difference
Workers' Compensation	\$300,000	\$300,000	\$0
Non-Workers Compensation	\$111,000	\$55,000	\$56,000
Total ULAE	\$411,000	\$355,000	\$56,000

However, no adjustments are made due to the immateriality of the amount of differences.

#### **4. Borrowed Money**

On December 29, 1997, the Board of Directors authorized the officers to borrow \$1,300,000 from Clayton R. Jones to be recognized as a loan by and to be repaid from the proceeds of the sooner occurrence or sale of maturity of the following U.S. Treasury securities now owned without encumbrance by the Company:

Face Amount	CUSIP	Coupon	Maturity
\$1,000,000	912827B50	8 ¼	7/15/98
300,000	912827VW9	8 1/8	2/15/98

On February 17, 1998, the \$1,300,000 borrowed money was paid in full.

## RED SHIELD INSURANCE COMPANY

### COMMENTS ON FINANCIAL STATEMENTS

#### Accounting Policies

Basis of Presentation – the financial statements included herein were prepared in accordance with statutory accounting practices prescribed or permitted by the Office of the Insurance Commissioner of the State of Washington.

Investments – investments are stated based on the National Association of Insurance Commissioners guidelines. Bonds and short term investments are at amortized value. Preferred and common stocks are valued at market. Mortgage loans are stated at the aggregate unpaid balance.

Non-admitted assets – certain assets such as receivables over 90 days past due, prepaid expenses, furnishings, equipment and EDP equipment not in compliance with RCW 48.12.010 are non-admitted assets.

Salvage and subrogation are recorded as reductions of losses incurred on a cash basis.

#### Bonds

**\$21,281,832**

The Company's investment in bonds represents 68% of total admitted assets as of December 31, 1998. The bond portfolio consisted of the following:

<u>Classification</u>	<u>Statement Value</u>	<u>Par Value</u>	<u>Market Value</u>
U.S. Government	\$17,651,743	\$17,685,000	\$18,174,900
State Territories, etc.	2,368,539	2,360,000	2,390,000
Political Subdivisions	961,550	940,000	940,000
Industrial & Misc.	<u>300,000</u>	<u>300,000</u>	<u>300,000</u>
Total	<u>\$21,281,832</u>	<u>\$21,285,000</u>	<u>\$21,804,900</u>

The Company uses the effective yield method to amortize bond premiums and discounts. Premiums and discounts on bonds classified as other than collateralized mortgage obligations are amortized in accordance with the NAIC Annual Statement Instructions manual. Collateralized mortgage obligation bond premiums and discounts are accounted for as prescribed by FASB 91, which requires that amortization be accelerated when prepayments of principal are received.

The testing of amortized values to maturity in accordance with the NAIC Examiners Handbook revealed no material differences.

#### Mortgage loans on real estate

**\$426,349**

Mortgage loans on real estate are stated at the aggregate unpaid balance. Most of the loans were made to immediate family members of the President who were not employees or officers of the Company. It was noted that there was no appraisal of the real property securing a mortgage loan at the time of the acquisition of the mortgage. This is not in compliance with RCW 48.13.140.

#### Losses and Loss Adjustment Expenses

**\$5,781,404**

The OIC casualty actuarial staff reviewed the reserves for the Company's unpaid loss and loss adjustment expenses. The Company's consulting actuarial firm, PricewaterhouseCoopers, LLP, provided loss and allocated loss adjustment expense development data by line of business. The OIC actuarial staff obtained additional information by interviewing several Company employees. The OIC actuarial staff also reviewed actuarial reports prepared by the Company's consulting actuarial firm, PricewaterhouseCoopers, LLP.



## **RED SHIELD INSURANCE COMPANY**

### **ACKNOWLEDGMENT**

The cooperation and assistance of the officers and employees of the Company during the examination are hereby acknowledged.

In addition, Timoteo L. Navaja, CFE, CIE, Insurance Examiner, Kehinde Ovbiebo, Insurance Examiner, and John Jacobson, AFE, Insurance Examiner and EDP Specialist, and D. Lee Barclay, FCAS, MAAA, ARM, Senior Actuary and Eric Slavich, Actuarial Analyst all from the Washington State Office of the Insurance Commissioner, participated in the examination and preparation of this report.

## RED SHIELD INSURANCE COMPANY

### AFFIDAVIT OF EXAMINER IN CHARGE

STATE OF WASHINGTON )  
 )ss  
COUNTY OF THURSTON )

TIMOTEO L. NAVAJA, being duly sworn, deposes and says that the foregoing report subscribed by him is true to the best of his knowledge and belief.

He attests that the examination of Red Shield Insurance Company was performed in a manner consistent with the standards and procedures required or prescribed by the Washington State Office of the Insurance Commissioner and the National Association of Insurance Commissioners (NAIC).

TIMOTEO L. NAVAJA, CFE, CIE  
Examiner in Charge  
State of Washington

Subscribed and sworn to before me on this \_\_\_\_\_ day of \_\_\_\_\_, 2000.

Notary Public in and for the State  
of Washington.